UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT, 1994

OVERVIEW

by the Secretary-General of UNCTAD

UNITED NATIONS

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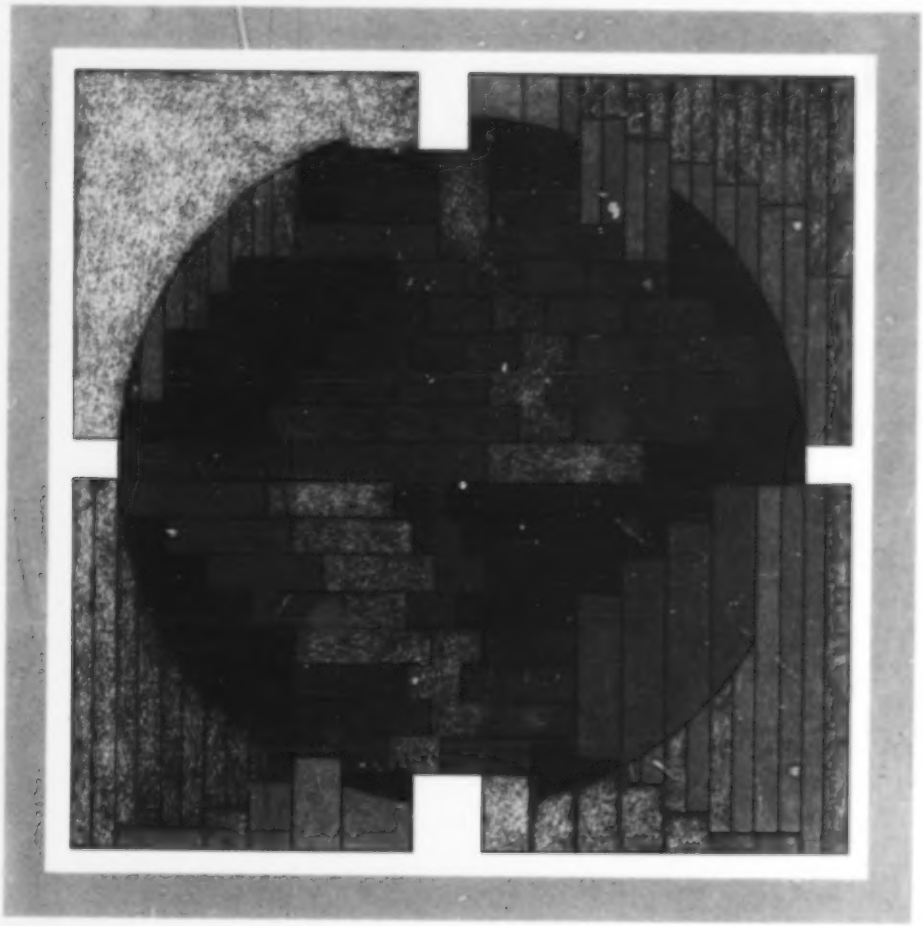

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UNCTAD/TDR/14(Overview)

OVERVIEW

by the

Secretary-General of UNCTAD

Global trends and the continuing deflationary gap

Slowly, the world economy is picking up. After several very lean years, output is expected to grow in 1994 by 2.5 per cent. This is much lower than is normal for a cyclical recovery, and even below the sustainable long-term growth rate.

For the developing countries, the picture remains much the same as last year. Their combined output is once again growing modestly (probably by 4 per cent in 1994), with the same marked disparities among different regions. Thus, economies in East and South-East Asia that performed well in the past continue to advance rapidly, Africa's stagnation persists, and the resumption of growth in Latin America remains at a slack pace. As regards external funding, developing countries continue to be bifurcated, with one group enjoying relatively easy access to international financing and another experiencing stringency.

Growth performance in *Africa* remains highly unsatisfactory. With output continuing to lag behind population growth, per capita incomes are heading downward, as they have done for a decade and a half. In the past few years, the economies pursuing "strong adjustment policies" have grown somewhat faster than others, but they have also received substantially more external funding. Moreover, as was discussed in last year's *TDR*, Structural Adjustment Programmes have failed to bring about the turnaround they

promised; so far only one African country has managed to graduate from them.

In several African countries, the main factor behind poor economic performance has been political unrest or armed conflicts of various kinds; and some have been struck by drought or other natural disasters. But over the years a problem common to these commodity-dependent economies - and to other such economies in other continents, including other least developed countries - has been the weakness of primary commodities, including oil. Falling export prices have depressed the export earnings of African countries notwithstanding increased export volumes, making it necessary to make huge cuts in imports.

Commodity prices began to recover in the autumn of 1993 and by the following April had on average risen by one third above their level a year previously. However, for the most part, these gains have proved short-lived, and prices of many commodities have in recent weeks been falling back. Coffee is an exception, and one of considerable importance to Africa, but the current price boom is not likely to last long.

African economies have not shared in the recent revival of capital flows to developing countries, and remain under intense financial pressure. Net flows of medium- and long-term export credits to Africa declined sharply to a negative figure in 1992, and total net flows of export credits were also negative in the first half of 1993. Very few countries have access to international bond markets and to bank credits, and no significant increases in foreign direct investment (FDI) have occurred, notwithstanding the liberalization of foreign investment laws.

Meanwhile, payments and financing arrangements for imports (which reflect countries' creditworthiness) are costly and carry unfavourable terms. In spite of concessional re-

structurings at the Paris Club, the servicing of external debt remains extremely difficult. A welcome initiative was taken at the Naples summit of the Group of Seven, aimed at deepening official bilateral debt reduction for low-income countries (most of which are African). It is to be hoped that this new political consensus will impart a strong impetus for early adoption by the Paris Club of the Trinidad terms, accompanied by country-specific measures when needed. Eligibility for the new terms should be widened to include, at a minimum, all severely indebted countries that borrow from both IBRD and IDA. Moreover, in order to expedite the conclusion of "exit" rescheduling agreements for countries carrying out adjustment programmes, debt stocks should be reduced as soon as possible, and in one go.

Recent growth performance in *Latin America and the Caribbean* has varied considerably, with some countries moving out of and others into recession, and with some registering acceleration and others deceleration. As a whole, growth continues to be much better than during the debt crisis, though weak when viewed in an historical perspective. The rise in output since the "lost decade" has stemmed more from the increased capacity utilization made possible by higher imports than from additional investment and improved productivity. With few exceptions, investment rates are modest, in some cases even lower than during the debt crisis, and higher domestic spending has tended to be driven by consumption. Private savings have declined in most countries, alongside major improvements in budget balances.

Exports have in general risen over the past year. The main impetus has come from the recovery in the United States, which has raised demand for the region's exports, and the increase in the imports of the Latin American countries themselves. The latter has spilled over to produce a substantial increase in intraregional trade. While the countries have been

taking a larger share of each others' exports, imports from the region have not been more dynamic than imports from elsewhere. Export diversification has progressed, largely through increased shipments of non-traditional primary or semi-processed products; diversification into manufactures is still slow, especially in comparison to some Asian economies.

The most striking feature of Latin American performance has been the huge inflow of funds from abroad, including repatriated capital. The $55 billion figure of capital inflows reported in 1993 is impressive, even though lower than the $62 billion for the previous year. The question is how long large-scale capital inflows will be sustained. Three quarters of the funds flowing in, other than FDI, have been fixed-interest securitized loans consisting of high-risk non-investment grade bonds (commonly referred to in the United States as "junk bonds") and high-cost commercial paper. Moreover, much of the FDI inflow, which has been copious in some countries, has stemmed from privatization, which is a one-off process; some of the purchases have been motivated by the prospect of early capital gains. The negligible amounts of syndicated bank credits, the onerous terms of international bond issues, ratings from the major credit-rating agencies and the evidence from trade finance all suggest that Latin America's creditworthiness has not yet been fully restored.

The flow is being driven in part by speculative behaviour in financial markets abroad. It is not a coincidence that capital flows to Latin America shot up soon after the end of a period of intense financial activity in the United States involving a surge of mergers and acquisitions financed by issuing high-risk, high-yield instruments (including "junk bonds"). It would seem that as debt deflation put an end to this speculative boom and the attendant opportunities for quick capital gains, hot money turned to "emerging markets" in Latin America and East Asia. Prospects of improved returns in the industrial countries or

other parts of the world, perhaps in the form of a speculative bandwagon in financial or currency markets, might prompt a reversal of such capital flows.

The flood of money has helped raise output and reduce inflation in the recipient countries. None the less, it has posed serious problems, by putting upward pressure on the real exchange rate, thus eroding the competitiveness and profits of manufacturing industry. This has occurred just as economic policy as a whole was being reoriented in order, among other things, to emulate the export and investment performance of East Asia. Some countries, such as Chile, have taken steps to discourage inflows motivated by short-term gains.[1] This approach appears to be useful, for there are dangers in too much financial openness. Capital account convertibility must not be turned into an objective of policy in its own right; it is a policy tool, and one among many, to be used when it serves development objectives, and avoided when it does not. Under the current global regime for international capital movements developing countries retain considerable flexibility in their policies (unlike developed countries, which are subject to commitments under agreements reached in OECD and EEC/EU). Recent experience serves to emphasize the importance of maintaining this flexibility.

There are, of course, also other, more fundamental issues in Latin America. Investment rates need to be stepped up considerably; but, poverty too, remains a serious problem. The dilemma is that to raise the share of investment in income generally requires increasing the share of profits, whereas alleviating poverty normally suggests a need to reduce income inequalities. Could the East Asian experience provide a way out? There, the pattern of landownership has been less skewed,

1 The potentially destabilizing influence of these flows and the measures to discourage them were reviewed in last year's *TDR* and that of 1992.

and corporate profits have been mostly saved and re-invested, rather than used for upper-class consumption.

In most of *developing Asia*, growth has continued to be strong. China continues to bound ahead despite inflationary pressures and social dislocations, while a number of countries in South Asia are beginning to join the growth pole of East and South-East Asia. The picture in West Asia has been very different because of the depressed price of oil and, in some countries, political impediments to normalizing external financial and trading relationships.

The dynamism of East and South-East Asia comes from a virtuous circle of growing investment and trade, rapid structural change and deepening industrialization. Imports have risen rapidly, from both within and outside the region. So, too have exports. Their main impetus has been the high rate of investment, but an important contributing factor has been the appreciation of the yen. Besides making current output more competitive, this has induced further relocations of more labour-intensive industries from Japan to developing countries in the region. A similar process, also involving investment flows, has been taking place in the Republic of Korea and Taiwan province of China. As a result, both the providers and recipients of regional FDI have moved up the industrial ladder. Thus, as noted in last year's *TDR*, the "flying geese" pattern has continued and exports to Japan have expanded, notwithstanding the recession in that country. External financing has been ample, and a handful of economies in the region account for the bulk of total syndicated bank credits to developing countries. Most of the FDI into the region has involved new investments rather than purchases of existing companies. In many countries, growth is being limited by the strain on infrastructure, rather than by unwillingness to take risks and innovate or by external financial pressure.

In *Central and Eastern Europe* as a whole, output continues to contract. The fact that the rate of contraction slowed considerably from 16 per cent in 1992 to 10 per cent in 1993 provides little comfort. A number of countries have bucked the general trend to register some upturn, and it is as yet uncertain whether this trend will be sustained. The situation in the former Soviet Republics is a particular cause of concern, especially since few of these new States are able to make up for their shrinking sales to each other by expanding exports to the rest of the world. Central European countries managed to switch their export markets at the beginning of the reform process, but appear to have largely exhausted their possibilities of doing so. The terms of official insurance cover remain restrictive for most countries in transition, and other costs of payments arrangements for imports also remain high.

The key question is how to accomplish the massive enterprise restructuring needed to create efficient units capable of responding to market signals. The machinery of government inherited from the past is too otiose for such an intricate operation. On the other hand, an entrepreneurial class and the institutional infrastructure required to sustain capitalist activity are highly underdeveloped, while a system to finance restructuring and investment is still present only in embryo. The future of the transition to a market economy is thus unsure. It is hardly surprising to find growing popular disaffection, both in countries where the Government is pursuing market-oriented reforms in earnest and in those where it is not. Governments, in turn, are becoming more pragmatic, and changing the reform agenda from simply dismantling the old system towards more subtle management of the transition process.

Growth in the *developed market economies* decelerated in 1993, falling to 1.4 per cent from the meagre 1.8 per cent of 1992. This reflected a contraction of output in the European Union (especially France and Germany) and no growth in

Japan. By contrast, in the United States and other English-speaking countries, where the recession started earlier, the pace of recovery quickened. Within Western Europe, those countries that cut their interest rates and let their currencies depreciate after the crisis of 1992 of the European Monetary System have fared better than Germany and countries choosing to maintain their parity with the Deutsche mark. Thanks to its (until recently) relaxed monetary policy, the recovery of the United States has been gathering momentum, and 3.4 per cent growth is expected for 1994. By contrast, the Japanese economy, still suffering from the bursting of the bubble in financial markets and in investment, is expected to register growth of merely 0.5 per cent. A stronger rebound is likely in Western Europe, but, as in Japan, the pace of expansion in 1994 will be very modest. Unemployment is therefore likely to continue to mount in Japan and Western Europe. In the United States, it has been declining, but whether this will continue depends critically on the pace of economic activity.

The short-term outlook is clouded by uncertainties relating to the policy stances of Governments and the behaviour of currency markets. In the United States, monetary policy has been tightened somewhat with the aim of preventing overheating. That objective is not in question; but the monetary brakes may be applied too hard and too soon if the inflationary danger is exaggerated. It will be unless it is borne in mind that the strong pace of investment in recent years has enlarged the supply capabilities of the United States economy, and that there is considerable slack in the world economy as a whole. In Japan, monetary policy has been extremely cautious for fear of a recurrence of the speculative bubbles that inflicted so much harm in the past. Again, the objective is valid; but the more potent danger today is continued deflation and currency appreciation. In Western Europe, monetary policy continues to be too tight. Prospects of recovery hinge on a revival in exports, which is

premised in part on a strengthening of the dollar vis-à-vis the Deutsche mark. However, the tendency has been in the opposite direction.

Pressure in currency markets has in recent months been in line with the need for trade-balance adjustment, with the yen (and, to a lesser extent, the Deutsche mark and the currencies closely connected with it) coming under strong upward pressure, and the dollar under downward pressure. But the more the dollar weakens relative to the yen (and the Deutsche mark), the more will world demand shift away from Japan (and Western Europe) towards the United States, increasing the already wide disparities in growth. The exchange market pressures will help or hinder recovery, depending on how monetary authorities choose to react. If the Federal Reserve Board opts for monetary tightening to counteract the impact of dollar weakening on the domestic price level, recovery in North America, as well as overall, will be slowed; moreover, trade conflicts between the United States and some of its trading partners might well intensify. Alternatively, if fears of losing competitiveness induce the Deutsche Bundesbank and the Bank of Japan to ease up, the global upturn will be strengthened.

* * *

However, adjustments in monetary policy alone will not be sufficient to tackle the main cause of current slow growth in the developed market economies, namely persistent inadequacies in the pace and pattern of demand creation. These stem from the radical change of approach towards economic policy-making that took place in the 1980s, which was hostile to demand management, especially as a means of boosting economic activity. The new consensus on macroeconomics espouses a number of doctrines contrary to those held earlier:

that inflation is invariably a more serious threat than unemployment; that output growth depends primarily on supply-side factors and relatively little on effective demand; that attempts to stabilize the level of activity usually serve to destabilize it; that monetary policies affect prices not production; that fiscal deficits crowd out private investment, and raise interest rates rather than the level of activity; that a relatively high degree of unemployment is "natural"; and that rising unemployment is much more a reflection of artificial rigidities in labour markets than of weak demand for final output.

Policy, too, has moved a long way towards monetarism and fiscal orthodoxy, though the latter movement has in practice been slowed by political constraints, and was for a time derailed in the United States by a belief that lower taxation would evoke a vigorous supply-side expansion. Governments have been reducing their efforts to manage demand, but they have simultaneously been increasing the need for it by deregulating the financial sector. They have consequently increased the capacity of the private sector to push up (or pull down) the pace of credit creation, and thus generate fluctuations in aggregate spending and in economic activity.

The change of policy regime has kept inflation down. But it has also had a number of undesirable consequences:

- A deflationary gap has normally been present, since upturns have tended to be quickly smothered whereas downturns have been left to work themselves out;
- The real economy has been disturbed by waves of private debt and credit-creation and contraction, in the course of which speculation has naturally thrived; and
- There have been large imbalances in current account positions and consequent strains in foreign exchange markets and the trading system.

These phenomena not only have been responsible for problems that are apparently obviously cyclical in origin, but also have substantially contributed to problems that are apparently structural, such as mounting unemployment and trade imbalances.

In the 1980s, domestic demand in the United States leaked abroad on a large scale and international imbalances widened as many industrialized countries pursued tight monetary and fiscal policies, while the United States adopted a combination of monetary restrictiveness and "supply-side" fiscal relaxation. The Plaza agreement sought to tackle the problem by lowering the value of the dollar through changes in monetary policies. However, Japanese firms adjusted in an unexpected manner, by investing heavily in cost-reducing techniques in order to retain their market share in the United States; financing investment was made especially cheap by the inflation of asset prices. Meanwhile, the weakening of the dollar eased the pressure on United States firms to recover their market shares by investing and restructuring.

Eventually, expansion in the developed market economies was brought to a halt by the debt-inflation process.[2] The combination of this process with the imbalances built up earlier has shaped the course of events in the 1990s. In the United States, firms have finally been pushed into downsizing and restructuring their capital stock. For that reason, the recovery was initially much weaker than in previous cycles, and output grew without (until recently) a corresponding increase in jobs. But, on the other hand, productivity has increased at rates not seen since the 1960s. The United States has thus been able to regain competitiveness because of the decline both of the dollar and of production costs.

2 This process was reviewed extensively in previous *TDRs* (1991 and 1992).

Japan has found adjustment to this situation extremely difficult. The fact that it is still in recession, despite three packages to stimulate the economy, suggests that the mismatch between capacity and demand is deep-rooted.

Western Europe responded to the depreciation of the dollar following the Plaza agreement by increasing private investment, stimulated by the establishment of the single European market. This, together with the increase in German government expenditure for unification, helped to forestall recession. However, the path to monetary union set out in the Maastricht Treaty required substantial reductions to be made in net government expenditures, just as the downturn was occurring in other industrialized countries. The Bundesbank's decision to slow German growth through tighter monetary policy put additional deflationary pressure on EU members. Those countries that have remained in the Exchange Rate Mechanism (ERM), and continued to impose fiscal restriction to satisfy the Maastricht convergence criteria, now face the same problem as Japan, i.e. inadequate home demand and heightened foreign competition.

As already noted, hopes for expansion in Western Europe hinge once again on exports. But the United States and Japan, too, are counting on rapid export growth. They cannot all simultaneously increase their exports by reducing labour costs. They can do so only if global demand is increased.

One telling symptom of global demand deficiency is the fact that surpluses are again being valued not only as a means of financing long-term lending, but as a prop to economic activity. Similarly, deficits are again deplored not only because they add to debt but, even more, because they reduce jobs and profits. The idea that countries should seek growth by improving their overall competitiveness vis-à-vis others is fast becoming accepted as an axiom. Nevertheless, this mercantilist

idea is very largely mistaken. Competitiveness is a relative concept: while one country can improve its international competitiveness (and thus, perhaps, its growth performance), it is not possible for all countries to do so at the same time.

What each and every country can do is improve productivity. Here, too, there is a simple truth that warrants repetition. Improvements in productivity do not raise output unless they are matched by an enlarged volume of monetary expenditures. Otherwise, technical advance will reduce the overall use of labour and raw materials, not only their use per unit of output; and this will in turn put pressure on individual countries to increase their market share at the expense of others. In short, global demand deficiency is a recipe for waste, unemployment, depressed commodity prices, and conflicts among nations.

The level of global demand is not an accident of fortune. While no individual country on its own is large enough to regulate the level of demand, Governments acting collectively have it in their power to do so, in order to ensure that it is compatible with worldwide growth and equilibrium. It is to this task that the international community should now turn:

- Western Europe needs to bring down interest rates substantially for a prolonged period, and to postpone its fiscal adjustment until recovery is well under way;
- Japan needs to loosen its monetary policy and undertake fiscal expansion, while taking steps to increase the share of consumption in national income;
- The United States needs to be cautious in applying monetary brakes, so as not to stifle the recovery of investment and employment and the improvement in productivity;
- The flow of capital resources to developing countries and countries in transition should be increased, in forms that are sustainable and predictable.

The Visible Hand and development experience in East Asia

The changed approach to economic policy in the 1980s has affected not only macroeconomics but also development strategy. Here, too, thinking has turned in favour of a minimal role for the State. Unlike in the "development economics" of the 1950s and 1960s, the emphasis is now on "government failure", on the capacities of the private sector; on the benefits of openness; on the gains from letting the price mechanism determine resource allocation; and on the costs of selectively promoting industries.

However, the pendulum has swung too far. The experiences of some of the most successful economies in the world - Japan, Republic of Korea and Taiwan province of China - have shown that government intervention can be extremely effective in advancing development.

The success of government policy in these economies reflected the fact that accelerating capital accumulation, industrialization, technological transformation, and growth and diversification of exports were the goals of economic policy not only in words but also in deeds. Unlike many other countries where the State intervened extensively, the Governments were not populist, seeking to advance the interests of other classes at the expense of Business. Still less were they ideologically hostile to private ownership or initiative. Nor, again, was their prime purpose to grant special favours to certain private interests. Rather, they sought to support and advance the growth of the private sector. Not, it must be emphasized, by depressing the living standards of workers and farmers, but by accumulating new wealth. Governments found that to serve Business to the full, they had also to act as its master. They did so by shaping and manipulating market forces in order to ensure that

individual firms acted not only in their own immediate self-interest, but also in harmony with the long-term interests of Business as a whole.

Broadly speaking, Government intervention in Japan, Republic of Korea and Taiwan province of China was designed to counteract a number of factors that typically limit the capacity and willingness of individual firms in developing countries to undertake long-term investments and modernize their methods of production and organization. It was directed at accelerating the pace of both growth and structural transformation, by changing the composition of industry through rapid capital accumulation, and by increasing the dynamism and efficiency of the industrialization process as a whole. It sought to make profitable sectors and activities which would not have been attractive to investors in a regime of laissez-faire, but which could be expected in due course to be able to withstand international competition. And it sought to stimulate the "animal spirits" of investors, strengthen their confidence, lengthen their time horizons, coordinate their expansion plans, and enlarge their command over resources.

Policy was formulated in partnership with business. In Japan, for instance, the key Ministries closely coordinated their policies with the private sector within the framework of an overall indicative plan. Deliberative councils and industry associations played significant roles in harmonizing the views of the public and private sectors and those of members of a particular industry. Cooperation between Government and business was facilitated by an oligopolistic structure whereby firms were organized into large, diversified business groupings (*keiretsu*) with cross shareholdings and subcontracting relationships with a large number of small and medium-sized enterprises. The situation was similar in the Republic of Korea, where family-based business conglomerates, the *chaebols*, were predominant, having been deliberately encouraged by the

Government to correct the dearth of entrepreneurship. This, and the fact that the banks were publicly owned, facilitated an industrial policy similar to Japan's. In Taiwan province of China public enterprises were more important because private firms, though numerous, were too small to establish the key industries which required large-scale investments and business organization.

"State-created rents" were the centrepiece of government intervention. As pointed out long ago by Schumpeter, entrepreneurial innovation requires the lure of high profits. But the market mechanism is often unable alone to provide sufficient rewards for pioneering by firms in a developing country, since these face experienced foreign competitors. In such circumstances, if private business is to increase production capacity and productivity, compete aggressively for increased market share, and establish new industries, it needs additional incentives and subsidies.

The most important subsidies came from repressing interest rates, and from divorcing domestic prices from international ones. As has been demonstrated in the World Bank's recent study, *The East Asian Miracle*, Japan, the Republic of Korea and Taiwan province of China had greater levels of price "distortion" than, for example, Brazil, India, Mexico, Pakistan, and Venezuela. The most lucrative rents of the State, namely profits from import licences, were linked to strong export performance. As a general rule, subsidies carried conditions designed to improve overall economic growth.

Rapid industrialization reflected the swift pace of capital accumulation, without which these countries would have been unable to attain the productivity growth that they did. Their investment ratios were among the highest in the world. The initial boost came from abroad; but consumption was made to

lag behind income growth to yield rising rates of domestic savings.

The extraordinary savings performance of these countries has not received a satisfactory explanation. Rapid income growth was certainly a factor, but this does not translate automatically into high savings rates. Since it was in corporate rather than household savings that the East Asian economies greatly outperformed Latin America, it would seem that part of the explanation lies in the way the policy regime affected corporate profits. By lifting profitability through rent generation and other means, government intervention served simultaneously to enhance the incentive of firms to invest and their capacity to finance new investment; investment was channelled into activities that maximized overall growth; this in turn increased profits, by allowing capacity to be more fully utilized and by quickening the pace of productivity improvement, which increased the overall rate of investment. A "virtuous circle" was thus set in motion, with strong propensities to save, invest and innovate feeding and being fed by profits growth. The importance of the investment-profits nexus in these economies is indicated by the high share of profits in value added.

Nevertheless, the income distribution was relatively egalitarian, largely because reforms in the system of land tenure had removed big landowners. The more even distribution of income appears also to have helped the development process by limiting demand for imported consumer goods and increasing the market for the products of traditional artisans and modern small- and medium-sized industries. This made it easier for Governments to sequence domestic machinery production before costly consumer durables such as motor cars, as well as avoid the extreme technological dualism typical in Latin America.

Growth went hand-in-hand with long-term transformations in the balance of payments, which lifted the foreign ex-

change constraint. Investment growth laid the foundations for future export growth by expanding and modernizing production facilities, while current export growth made it possible to step up investment. Industrial policy kept up the momentum by encouraging private sector investment and innovation, and directing it to those sectors where international trade was likely to expand most or the potential for productivity gains was greatest. This required giving priority to heavy and chemical industries, rather than allocating resources according to static comparative advantage.

The three economies displayed differences in the degree of trade dependence, reflecting differences in their size. Japan's internal market was large enough to allow the achievement of both economies of scale and (oligopolistic) competition in heavy and chemical industries without dependence on export markets; while these industries were being built up, the labour-intensive industries provided the main source of foreign exchange. In the Republic of Korea and Taiwan province of China, the rapid expansion of labour-intensive exports in the 1960s created a market for imported intermediates and capital goods, while industrial policy encouraged secondary import substitution, including heavy and chemical industries. These industries had to be pushed into exporting more quickly than in Japan because the domestic market was too small to permit scale economies without monopolistic conditions.

In all three economies, Governments engaged in a variety of selective interventions:

- In their *trade policy*, all supported industrial deepening and the development of national firms, with selective incentives to promote exports (including tariff rebates, tax exemptions on export earnings, short-term export credits), and selective protection, using foreign exchange controls and import quotas and tariffs. They liberalized specific

industries step-by-step only as they became internationally competitive;

- They restricted *foreign direct investment* to carefully selected sectors. FDI never exceeded 4 per cent and 2 per cent of gross fixed capital formation in the Republic of Korea and Taiwan province of China, respectively;
- The Republic of Korea, like Japan, put great effort into *research and development* to adapt and improve imported technology. Its spending on R&D reached 2.3 per cent of GDP, the highest among the developing countries. The Government provided significant fiscal subsidies and tax incentives;
- All three economies provided *fiscal support* of various kinds to facilitate equipment investment and capital accumulation. Measures to reduce the effective tax rate on corporate earnings and to allow new firms to retain higher percentages of profits, as well as tax exemptions, investment tax credits and industry-specific depreciation allowances, encouraged enterprises to retain and reinvest earnings. They also stabilized corporate earnings in the face of cyclical fluctuations and reduced investment risks;
- *Financial* incentives were also given selectively to promote the development of particular industries, and varied over time as industries evolved. Interest rates were kept generally low and stable in order to reduce the cost of investment and encourage long-term lending for investment in plant and equipment. Especially low rates were given to particular sectors early in their development, for example through preferential "policy loans" and "policy-based" lending. Designated industries received priority in allocating of bank credit, state investment funds and foreign exchange;

- *Competition* policy was oriented towards both productivity and capital accumulation. Some circumstances required restricting competition, and others required promoting it. In order to implement industrial policy, Governments granted exemptions to firms, particularly in export sectors, from laws governing monopolistic practices. They also sought to control capacity expansion and to coordinate market-sharing arrangements in order to achieve efficient-scale plants and manage excess competition. Mergers and cartels were encouraged to attain optimum production scale, particularly in export sectors. Early entrants won monopolistic positions, but firms were encouraged to compete for the prize; and as the industry matured, other firms were allowed in, so as to generate the required degree of competition. Technology screening was also used to sharpen competition, as well as to upgrade technology.

Industrial deepening progressed rapidly and far. The evolution of the structure of industry did not merely conform to changes in comparative advantage brought about by the exhaustion of the supply of surplus labour. It also owed a great deal to the visible hand of government. As economies of scale were achieved, capacity utilization rates increased, and technological capabilities developed, the new industries became competitive on world markets. But typically, before that happened they received substantial government assistance. For instance, the Taiwanese Government led the market, and sought to attract resources into particular sectors, establishing public enterprises where necessary. In the Republic of Korea, without government support, no private agent would have been willing to bear the risks of investing in the heavy and chemical industries.

In short, the "economic miracle" in these economies was not entirely a "miracle of the market". There can be no doubt that the profit motive was the force driving business, and that

capitalist enterprises were primarily responsible for carrying out economic development. Yet, it is very unlikely whether without the guiding hand of government, the "animal spirits" of the entrepreneurial class would have reached such a high intensity, or flowed spontaneously into developmental activities in a sequence capable of ensuring a continuous dynamic momentum. The economic policy regimes in Japan, Republic of Korea and Taiwan province of China should not be seen as deviations from laissez-faire capitalism. They correspond to another paradigm altogether, consisting of a forced-pace advance of industrial capitalism under the auspices of a State that was simultaneously the servant and master of business enterprise.

The fact that the Japanese model of industrialization was successfully adopted (and adapted) by two other economies in the region suggests that it can be applied in other places too. That is not to say it can be transplanted everywhere, any time. Each country confronts at any moment a unique situation which depends on a host of factors, including its own size, level of development, and past history, as well as the state of the world economy, something that is in constant flux.

Besides, it is also true that a number of countries (including some in East Asia that opened their doors wide to foreign direct investment) have been able to develop successfully with policies bearing little or no resemblance to Japan's. Moreover, various countries (for instance in Africa and Latin America) have failed precisely because they treated government intervention as a panacea.

These differing experiences suggest that our state of knowledge is as yet insufficient to provide a sure recipe for development in all circumstances. Scepticism rather than faith may therefore be in order. There may not be one right development strategy but several, depending on time and place.

But, of course, one cannot stop there: the challenge of development is too vast, especially in African and other least developed countries, for the economist to rest content with interpretations of things past. Rethinking development policy must also include finding workable solutions to the problems of the present and future. This is a task of great importance and urgency. It has been started, but it is not yet finished.

The Uruguay Round: An initial assessment

The main achievement of the Uruguay Round has been to effectively address those areas where the absence of international consensus and workable rules and procedures had given rise to ever-increasing trade tensions and disputes. Failure to reach agreement would have greatly exacerbated these tensions, leading to a "trade war" which would have seriously jeopardized the stability of the multilateral trading system and placed beyond reach solutions to other international economic issues.

The Agreements reached on safeguards, subsidies and countervailing measures, anti-dumping, agriculture, and textiles and clothing reassert, interpret and expand GATT rules in considerable detail, addressing issues which had given rise to misunderstandings and disputes in the past. Existing multilateral disciplines are now set out in terms of specific economic criteria rather than of rules and principles defined in normative terms. The increased predictability in the application of the trade measures governed by these Agreements should, in itself, significantly improve conditions for export-oriented investment.

Agreement on an effective and efficient multilateral safeguard system was of paramount importance in improving security of access to markets and reestablishing the credibility of multilateral disciplines. The Agreement on Safeguards has clarified and reinforced the disciplines for the application of safeguard measures, in particular by reaffirming the MFN

clause and explicitly prohibits voluntary export restraints and similar measures. The Agreement on Textiles and Clothing provides a framework for the phasing out of the Multi-Fibre Arrangement (MFA), thus reversing the trend of the past three decades toward the continuous extension and expansion of the discriminatory and restrictive regime directed against developing countries' major industrial export. At the end of a 10-year transition period, the same rules will apply to trade in textiles and clothing as to trade in other goods. This represents a serious setback for protectionist interests not only in the developed importing countries, but also for those in exporting countries that benefited from the economic rents.

A key feature of the Agreement on Subsidies and Countervailing Measures is the agreement reached on the definition of a "subsidy", reflecting an international consensus on the appropriate role for Governments in supporting production and trade. The Agreement identifies which subsidies are to be prohibited (those contingent upon export performance or upon the use of domestic over imported goods), permitted (i.e. "non-actionable" - in not being exposed to the possibility of remedial action), or applied only if they do not adversely affect the trade interests of other countries.

The Agreement on Agriculture constitutes an important first step towards stability and predictability in trade in agricultural products by establishing a binding "standstill and rollback" of protectionist measures in this sector, as a basis for further negotiations aimed at more meaningful liberalization and reform. Through "tariffication", all non-tariff measures affecting imports of agricultural products will be converted into bound customs duties, to be reduced by a fixed percentage. In many sectors, the tariffication process may not, in itself, provide any significant improvement in market access conditions; however, the minimum access commitment obliges countries to open a tariff quota equivalent to 3 per cent of domestic consumption,

to be increased to 5 per cent over six years. The new disciplines on agriculture also contain commitments to bind and subsequently reduce overall support to the agricultural sector; Governments are thus free to choose from a variety of options in achieving these results. The Agreement contains commitments for the reduction of export subsidies in terms of value (budget outlays) and volume.

The Agreement on Implementation of Article VI of GATT 1994, which represents the outcome of the third attempt to clarify the GATT rules on anti-dumping measures, provides more detailed rules on the procedures for initiating investigations, calculating dumping margins, determining the existence of injury and reviewing findings and undertakings. Negotiations in this area were characterized by the process of alignment with the practices of either the European Union or the United States, drawing on the experience acquired in the application of the Tokyo Round Code. The consequence was often alignment at a higher degree of discipline, although there are some significant exceptions.

Further trade liberalization

A major outcome of the Uruguay Round is an MFN tariff reduction in developed countries on industrial products by an average of 38 per cent on a trade-weighted basis, bringing tariffs down to 3.9 per cent on average. This significant reduction of tariff levels derived essentially from the "Quad" package negotiated among Canada, the European Union, Japan and the United States. Duty-free access for developing countries to these markets will significantly increase. The tariff reductions could serve to increase profits and stimulate export-oriented investment from retained earnings.

While developing countries stand to benefit from liberalization in all sectors, a significant proportion of their exports incur duties exceeding 10 per cent, in particular for products in sectors of export interest to them, such as non-tropical agricultural products, textiles and clothing, and leather and footwear; these are also the sectors with peak tariffs and tariff escalation. The momentum generated by the Uruguay Round should, however, be preserved since further tariff negotiations are already foreseen for the agricultural sector in 1999, while negotiations on services are to take place in 2000. Pending such multilateral action, improvement of their GSP schemes by preference-giving countries would be one way of mitigating this imbalance of results.

Most developing countries made substantial tariff concessions, consolidating the results of their liberalization programmes undertaken unilaterally, and bound their tariffs to an impressive extent. For several developing countries the average MFN tariff reduction on industrial products was comparable to, or greater than, that of OECD countries.

One of the objectives of the Uruguay Round was to correct the situation emerging from the Tokyo Round in 1979, where the nine Codes on non-tariff measures and certain product sectors had not been subscribed to by many GATT contracting parties, including most of the developing countries. A major result of the Uruguay Round has been the conversion of modified versions of these codes into Multilateral Trade Agreements which are binding on all WTO members. There has consequently been a dramatic increase in the levels of multilateral discipline for developing countries, particularly when the increases in bindings resulting from the tariff negotiations are taken into account.

The remaining four agreements retain their "plurilateral" character and are contained in a separate Annex to the WTO

Agreement. Of these, the Government Procurement Code was renegotiated in parallel to the Uruguay Round (but with a smaller number of signatories) and the renegotiation of the Agreement on Civil Aircraft is under way. The WTO Agreement leaves open the possibility of incorporating additional plurilateral agreements on the basis of consensus (one of which could well be the multilateral steel agreement that is at present under negotiation). These consensus provisions may well be required to prevent the concept of the so-called "conditional MFN" from penetrating WTO.

However, the liberalization and increased disciplines achieved are subject to certain qualifications and provisions which could lend themselves to abuse. The Agreement on Safeguards, for example, provides for the possibility of negotiating quotas with supplying countries, as well as for countries' deviation from strict MFN treatment where there has been a "disproportionate increase" of imports from certain supplying countries (the so-called "quota modulation" provisions). The Agreement on Textiles and Clothing provides that, during the transitional period, new restrictions can be negotiated or imposed under a "transitional safeguard mechanism", on a discriminatory basis, when importing countries determine that imports of textile and clothing are causing "serious damage" to their domestic industries. A vague link to other commitments could be viewed by certain importing countries as an excuse to introduce an element of negotiation into the liberalization programme.

The liberalizing impact of the Agreement on Agriculture is mitigated by a special safeguard clause which permits members to impose an "additional duty" on imports of those items subject to tariffication, if the volume of imports of a given product exceeds a "trigger level" in relation to domestic consumption or when import prices fall below a "trigger price". Within the tariff quotas provided, quotas have been allocated to spe-

cific suppliers to preserve their "current access opportunities". The preeminence of the Agreement on Agriculture is confirmed by the "peace clause", which ensures that actions taken in "full conformity" with the provisions of the Agreement cannot be challenged under the related provisions in the Agreement on Subsidies and Countervailing Measures, nor even under certain aspects of the Dispute Settlement Understanding.

On anti-dumping measures, the codification and alignment of current practices of the major trading countries has, in certain cases, resulted in lower levels of discipline and the legitimization of practices unfavourable to developing countries. Anti-dumping actions will be subject to a less stringent standard of review in dispute settlement procedures than that applied in other Agreements, obliging panels to accord relatively greater deference to the decisions of the administering authorities and to the provisions of the implementing legislation. In view of the relatively greater stringency introduced in the other Agreements, recourse to anti-dumping action may become even more the preferred "trade remedy" for protectionist interests.

Extension of multilateral disciplines

Initiatives to establish multilateral rules for the protection of property rights have a relatively long history. In the present "globalized" world economy, these initiatives have been broadened to address the whole spectrum of impediments which restrict the global operations of enterprises and concern not only traditional objectives, such as the "right of establishment" and "national treatment", but also access to telecommunications networks, the movement of executives and specialists, and the avoidance of conditions on investment that inhibit the execution of a global production strategy. Intellectual property has become a key element in comparative advantage; differ-

ences in levels of protection of intellectual property rights were leading to increased trade tensions, and the universal protection of such rights has become a major priority. The Uruguay Round embraced the negotiation of new multilateral disciplines in the areas of intellectual property and trade in services, linking them to the GATT rights and obligations through the institutional "umbrella" of WTO and its dispute settlement mechanism.

The General Agreement on Trade in Services (GATS) establishes an entirely new contractual framework to govern trade in services, based on its definition of such "trade" and the general obligation to provide unconditional MFN treatment for all measures affecting such "trade" in services. Each country's commitments with respect to national treatment and market access are confined to those relating to the sectors, subsectors and modes of supply specifically included in its individual Schedule of Commitments. The Agreement provides a framework within which developing countries will be able to obtain reciprocity for any further liberalization they undertake with respect to trade in services.

The most impressive feature of GATS is not so much the degree of liberalization that it has achieved, but rather the extension of the scope of multilateral trade rights and obligations to cover measures affecting such diverse aspects as foreign direct investment, professional qualifications, and the movement of persons and electronic data across national frontiers, thus making them legitimate subject-matter for inclusion in the negotiation of future trade commitments under GATS, as well as in other trade agreements. Despite strong lobbying efforts by protectionist interests, its scope covers all service sectors (only air traffic rights being excluded). There is, however, a considerable imbalance as to the extent to which different sectors or "modes of supply" have been made subject to specific commitments in the Schedules.

The Agreement on Trade-Related Investment Measures (TRIMs) does no more than prohibit such measures that contravene the GATT obligations and rules on national treatment and quantitative restrictions; it does not deal with the rights of investors *per se*. Those rights are addressed in GATS (rather than in the TRIMs Agreement), where it is clearly stipulated that neither "establishment" nor "national treatment" are "rights", but can be the subject of qualified concessions exchanged on a reciprocal basis (including concessions in other modes of supply such as the temporary movement of persons) with respect to specific sectors or subsectors. However, GATS implicitly recognizes the right of home countries to defend the interests of foreign affiliates of their enterprises through the dispute settlement provisions. Extension of the GATS approach of sector-by-sector negotiations on commercial presence, in exchange for benefits with respect to other modes of supply or other service or goods sectors, might provide a technique for bringing investment into the WTO orbit in a future round of negotiations.

Through the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), the essential provisions of the international conventions governing intellectual property protection have been made universally applicable on an MFN basis, given a binding character and incorporated as inherent rights enshrined in the multilateral trading system. The Agreement establishes disciplines for copyright, trade marks, geographical indications, industrial designs, patents, layout designs of integrated circuits, and protection of undisclosed information, in certain instances going beyond the provisions of the WIPO conventions. It provides new rules with respect to issues which had not been resolved in WIPO forums, the most important of which was acceptance that all products or processes in all fields of technology will be patentable. Other key aspects in this regard relate to copyright protection for com-

puter software, protection for data banks and phonogram producers, the term of patent protection, the protection of undisclosed information, and civil litigation procedures. With the exception of certain commitments to encourage technology transfer to the least developed countries, there are no special provisions to facilitate the transfer of technology to developing countries.

Developing countries are likely to incur costs in applying this regime: these will relate not only to higher royalty payments to foreigners, and the increase in prices of products manufactured under licence or imported, but also to the administrative burden of implementing the Agreement. At the same time, however, there could be a greater incentive for enterprises to invest in developing countries and to license patented inventions to entrepreneurs in those countries.

Differential and more favourable treatment

The dramatic increase in the level of discipline accepted by developing countries through their acceptance of all the multilateral trade agreements resulting from the Uruguay Round and the binding of their tariff schedules has significantly reduced the flexibility of Governments in the use of trade and domestic policy instruments. Consequently, many WTO members will not be able to emulate the development strategies pursued successfully by many countries in the past and will need to adapt to the constraints and opportunities of the new system.

The provisions in various Agreements for differential and more favourable treatment go some way to remedy this situation. Many take the form of "best-endeavour" clauses, time-bound exceptions from obligations and longer periods for implementing obligations, flexibility in procedures and access to technical assistance and advice. In certain Agreements, dif-

ferential and more favourable treatment has been given a more precise, contractual character, particularly in the form of numerical thresholds for undertaking certain commitments or of exemption from others. The promotion of development is an inherent objective of GATS as well as a general obligation, and it is not stated in terms of "special" treatment. In several Agreements account has also been taken of special problems faced by the countries in transition to market-based economies by introducing more flexibility in their respective obligations.

Development strategies in future will nevertheless have to be adapted to the post-Uruguay Round trading system. The success of such strategies will depend upon the effectiveness of WTO in ensuring secure access to markets and in preserving the momentum to further multilateral trade liberalization.

The least developed countries

The Punta del Este Ministerial Declaration recognized the need for "positive measures to facilitate the expansion of trading opportunities" for the least developed countries (LDCs). The Marrakesh Ministerial Decision on this subject exhorts members to implement expeditiously the provisions contained in the various Agreements in favour of those countries. In those Agreements which provide for differential and more favourable treatment for developing countries in general, more generous treatment is extended to LDCs, usually in the form of longer periods for compliance with and implementation of obligations. A Ministerial Decision was adopted as a political message to mobilize the support of Governments, through technical and financial assistance for food aid, as well as that of the multilateral financial institutions, to take action to mitigate the impact on the LDCs and net food-importing countries

of the higher food prices that were expected to result from the new multilateral disciplines on agricultural export subsidies.

None the less, the poorer developing countries, including the LDCs and other developing countries in Africa, have emerged confronted by special difficulties on account of the erosion of the preferential margins they enjoyed (particularly under the Lomé Convention), the expected increase in the cost of imported technology and in the price of imported foodstuffs, and the much higher level of both legal and procedural obligations that they have assumed. The African countries, in particular, are not in a position to cope with additional challenges of this nature. There exists, therefore, a pressing need to devise measures to translate the recognition of the special problems of these countries in this respect into concrete action, as well as to assist them in taking maximum advantage of their new opportunities.

The revival of multilateralism

The Understanding on Rules and Procedures Governing the Settlement of Disputes substantially strengthens the dispute settlement mechanism and hence also the multilateral trading system. It ensures a complainant the right to the establishment of a panel, which must proceed through pre-determined successive stages in accordance with a clearly specified timetable. No member will be able to delay, postpone or block a decision. Panel reports are to be approved by the Dispute Settlement Body unless there is a consensus to reject them. Members are committed not to make a determination to the effect that a violation of obligations or other nullification or impairment of benefits has occurred except through recourse to this multilateral mechanism. The final recourse in a dispute remains that of the "suspension of concessions" (i.e. retaliation), which must

be authorized and, in certain yet undefined instances, can be "cross-sectoral" (i.e. as between rights and obligations relating to trade in goods, trade in services and intellectual property rights). How this will affect developing countries (which initially opposed "cross-sectoral" retaliation) remains to be seen.

Another pre-Uruguay Round concern was that the multilateral trading system would degenerate into competing and mutually antagonistic "regional blocs" and a return to the policies of "spheres of influence" of the major powers, particularly if the Round failed. However, the outcome of the Round has served to dilute many of the discriminatory aspects of regional agreements, by reducing tariff preferences for regional partners through multilateral tariff reductions, and by establishing disciplines of equal or greater stringency than those in the regional agreements, thus "multilateralizing" large elements of such agreements. While the preeminence of the multilateral system has thus been reestablished, the momentum must be continued to ensure that regional trading arrangements remain a secondary and constructive option.

The Uruguay Round has also resulted in the extension of multilateral trade disciplines to cover a much larger number of countries, due to the recent accession to GATT of many developing countries. All WTO members will be subject to roughly the same level of multilateral obligation; any exceptions, including differential and more favourable treatment, are defined in precise terms. China, which participated in the Uruguay Round while negotiating its resumption of contracting party status, is still carrying out negotiations with a view to becoming an original member of WTO. If China, given the dynamism of its economy and its rapidly increasing importance in international trade, were to remain beyond the reach of multilateral rules and disciplines, the effectiveness of WTO in achieving its objectives would be diminished. The Uruguay Round furthermore attempted to adapt to the new situation arising from the

dissolution of the USSR and the transition to a market-oriented economy by the newly independent States; in the later stages of the negotiations additions were made to several Agreements which took into account the specific problems faced by these countries in the transition process. Most of the countries concerned which are not contracting parties have initiated procedures for accession to GATT.

The WTO and future negotiations

Specific provision is made in some agreements for further negotiations, while in others comprehensive reviews of the operation of the Agreements are envisaged, usually within five years. Assuming that the WTO Agreement enters into force in 1995, multilateral negotiations will thus begin on a wide range of issues around 1999-2000, without any specific decision to this effect being required.

Meanwhile, countries face the challenging task of implementing the Agreements. These provide a mechanism for countries to effectively defend and pursue their interests if they have the requisite resources. The detailed elaboration and tightening of multilateral disciplines, the introduction of new concepts and detailed criteria for their application and the improvement of the dispute settlement mechanism provide new scope for action against trade-restrictive measures; countries, particularly the major trading nations, may accordingly be encouraged to initiate litigation to assert and clarify their rights and obligations.

Many developing countries, as well as the countries in transition, will be faced with serious challenges with respect to institutional capacity, human resource development and information management. Effective utilization of the Agreements requires coordinated governmental machinery on trade matters,

in order to monitor compliance with the new rules by their trading partners, as well as to bring national legislation into conformity with the new rules and establish the institutional mechanisms for the purpose. Technical assistance programmes designed to assist these countries to respond to these challenges will undoubtedly be necessary.

The WTO Agreement (which some have described as a "mini-charter") is strictly institutional and procedural in character, and has no substantive rules or principles other than those which are included in the annexed Agreements. Its primary function is to link all the Multilateral Trade Agreements together, subject them to a common dispute settlement mechanism, and provide the framework for the implementation of the results of negotiations, on either a multilateral or a plurilateral basis. It commits its members to ensure conformity of their laws, regulations and administrative procedures with the obligations in the Agreements and also abolishes the "grandfather rights" (with one exception) which enabled countries to maintain mandatory legislation otherwise inconsistent with their GATT obligations. At the initial stage of its activities, the main objectives of WTO would consist of ensuring full and faithful implementation of the Uruguay Round Agreements.

As the negotiations concluded, the question of the future work programme was linked to the acceptance of the final package: acceptance by some countries was made conditional upon decisions to include certain new issues in the work programme of the WTO Preparatory Committee. In this connection certain developed countries laid particular stress on (a) links between trade rights and environmental measures, (b) multilateral rules on competition policy and (c) links between trade and labour rights. A series of additional proposals were submitted in Marrakesh which included the relationship between immigration policies and international trade; trade and investment; regionalism; the interaction of trade policies and

policies relating to financial and monetary matters, including debt, and commodity markets, international trade and company law; compensation for the erosion of preferences; the link between trade, development, political stability and the alleviation of poverty; and unilateral or extraterritorial trade measures.

The Uruguay Round resulted in an extension of the scope of multilateral trade disciplines to cover those aspects of technology, investment, immigration policy and communications where Governments were willing to accept contractual obligations linked to their market access concessions. It did not attempt to address these issues in a comprehensive fashion. The extent to which the scope of WTO will be enlarged to encompass additional "trade-related" areas will be determined by the willingness (or reluctance) of countries to submit their policy measures in additional fields to contractual obligations that could expose them to the threat of possible trade sanctions.

The tendency to emphasize, or even exaggerate, the importance of the institutional result of the Uruguay Round, as opposed to the substantive results embodied in the constituent Agreements, may have had the unfortunate effect of setting up WTO as a target against which protectionist forces can rally. Political interest groups, driven by essentially parochial sectoral protectionist interests, are uniting to oppose ratification of the WTO Agreement on the basis of supposed threats to "national sovereignty". Similarly, the conversion of GATT into WTO appears to be used by others to claim that the institutional outcome of the Uruguay Round is a reason for downgrading the involvement of the United Nations proper in trade and development issues.

The relationship of WTO with the United Nations system and other international organizations remains to be defined At its forthcoming forty-ninth session the General Assembly will be considering the strengthening of international organiza-

tions in the area of multilateral trade and in this context will have an opportunity to make proposals for ensuring the effective cooperation and complementary roles of these organizations.

The subjects referred to above for possible inclusion in the WTO work programme include wider economic, social and political issues that may both influence, and be influenced by, trade flows. But should the main thrust of further multilateral trade negotiations be to seek to establish disciplines in all areas where differing national standards and practices can affect competitiveness in international trade, thus extending the scope of trade disciplines even further into the areas of domestic policy measures and private sector practices? Would this not give rise to concern that there would be a significant strengthening of the arsenal of protectionist "trade remedies"? There is also the issue of how to address the problems - social, economic and other - that arise from changes in the size and direction of trade flows, and to devise mechanisms to assist those countries which may be disadvantaged, at least temporarily, by the inevitable adjustment process, as well as to provide a "safety net" for those which will simply be unable to compete effectively in the foreseeable future. The extent to which these various issues can be dealt with through the extension of multilateral trade disciplines depends on the factors mentioned above. Many "trade-related" issues could also be considered as problems of "governance" in the United Nations context.

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